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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1931

No. 528

PEIRCE COOMBES,

Petitioner,

vs.

MILTON E. GETZ,

Respondent.

BRIEF FOR RESPONDENT

On Writ of Certiorari to the Supreme Court of the State of California—82 Cal. Dec. 103, 1 P. (2d) 992, R. p. 37 (July 23, 1931); rehearing denied 82 Cal. Dec. 556, 4 P. (2d) 157, R. p. 51 (August 21, 1931).

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BRIEF FOR RESPONDENT

On Writ of Certiorari to the Supreme Court of the State of California—82 Cal. Dec.* 103, 1 P. (2d) 992, R. p. 37 (July 23, 1931); rehearing denied 82 Cal. Dec. 556, 4 P. (2d) 157, R. p. 51 (August 21, 1931).

STATEMENT OF THE CASE.

Petitioner is assignee of a claim for $617.50 against Getz Bros. & Company, a California corporation (R. p. 1). In 1925 he brought this suit on behalf of himself and other creditors (R. p. 19) to recover from the directors of Getz Bros. & Company sums in excess of $550,000, which

*The reference is to "California Decisions," the unofficial advance publication of the opinions of the appellate courts of California. The case has not yet appeared in the official reports.

he alleged had been embezzled by an officer of the corporation. The method of the alleged embezzlement is set forth in the complaint (pars. VII-VIII, R. pp. 2-11), but is immaterial here, because it is admitted that Milton E. Getz, the sole respondent, had no connection with the embezzlement, and that the only basis for the assertion of any liability against him is the hereinafter mentioned provision which was in the California constitution until November 4, 1930 (see R. pp. 12-13).

The trial court sustained a demurrer to the complaint on the ground that the alleged cause of action was barred by the statute of limitations (R. pp. 27-30). Petitioner declined to amend and appealed to the State Supreme Court. While the appeal was pending, the constitutional provision was repealed without a saving clause (R. p. 37). The respondent thereupon moved to dismiss the appeal on the grounds that the cause of action had been extinguished by the repeal of the constitutional provision. The court granted this motion (R. p. 37; 82 Cal. Dec. 103, 1 P. (2d) 992). A petition for rehearing was denied (R. pp. 50, 51; 82 Cal. Dec. 557, 4 P. (2d) 157). Certiorari was granted by this court on January 11, 1932.

THE QUESTION INVOLVED.

The provision on which this suit is based was a part of section 3 of article XII of the California constitution (1879) as follows:

> "The directors or trustees of corporations and joint-stock associations shall be jointly and severally liable to the creditors and stockholders for all moneys embezzled or misappropriated by the officers of such

corporation or joint-stock association, during the term of office of such director or trustee.'"*

The repealing measure which was proposed by the legislature in 1929 (Cal. Stats. 1929, p. 2239) and adopted by vote of the people on November 4, 1930, contained, as above stated, no saving clause.

At all times from the adoption of the constitution of 1879, and both before and after the repealing measure of November, 1930, article XII was entitled "Corporations" and section 1 thereof contained a reserved power to alter and repeal, as follows:

> "All laws now in force in this state concerning corporations and all laws that may be hereafter passed pursuant to this section may be altered from time to time or repealed."

While petitioner raises two or three questions as to the meaning of the foregoing provisions, we believe, under the authorities later cited (infra, Argument, *Sixth*), that these are clearly questions of state law as to which the decision of the State Supreme Court in this case is controlling. The sole question in the case, we think, is: Did the Supreme Court of California, by holding that the repeal of the constitutional provision extinguished peti-

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*This provision was self-executing (*Winchester v. Howard*, 136 Cal. 432, 439-441, 64 Pac. 692, 69 Pac. 77). The statutes of California contained no provision relative to directors' liability for misappropriations or embezzlements of money by corporate officers; this liability depended on the constitution alone.

In quoting section 3 of article XII as it read prior to November, 1930, petitioner quotes the provision for *stockholders'* liability, as well as the provision for directors' liability (Supplement to Petitioner's Brief, p. 6). The stockholders' liability is *not* involved in this case. That liability, unlike the directors' liability here under consideration, was embodied in a statute of the state as well as in the state constitution (Civil Code, Sec. 322). The legislature, in 1931, repealed the stockholders' liability statute, but did so with a clause saving liabilities incurred prior to its passage (Cal. Stats. 1931, Ch. 257, p. 444; Ch. 862, Sec. 1, p. 1763).

tioner's cause of action which had not been reduced to judgment, give the repeal an effect violating the impairment of contract clause (section 10, Article I) in the Constitution of the United States? This question, in turn, largely depends upon the effect to be given the reserved power of repeal in the constitution of California. The nature of the question can, we think, be made more clear by a comparison of petitioner's theory with that of the State Supreme Court.

COMPARISON OF THE PETITIONER'S THEORY WITH THAT OF THE STATE SUPREME COURT.

We do not dispute petitioner's starting point, that the directors' constitutional liability under the decisions of the state court is "contractual"* (Supplement to Petitioner's Brief, pp. 13-14). From this he argues that when he (by his assignor) extended the credit of $617.50 to Getz Bros. & Company, there was created by operation of law a contractual liability on the part of the respondent as a director for any embezzlement or misappropriation of corporate funds by corporate officers, and that, to the extent that the subsequent repeal of the constitutional provision operated to cut off petitioner's claim under that provision, it is an illegal impairment of contract.

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*In describing a liability of this kind as "contractual" or "remedial," as distinguished from "penal," the courts ordinarily mean only that the extent of the liability is measured by some element of actual loss (*Huntington v. Attrill*, 146 U. S. 657. It was on this principle that the Supreme Court of California held that, while the constitutional liability was imposed on an innocent director so as to make him surety for misappropriations or embezzlements of corporate funds by corporate officers, it was nevertheless in a technical sense "contractual," not "penal," because the extent of it was measured by the loss to the corporation, no additional recovery being allowed by way of punishment (*Dean v. Shingle*, 198 Cal. 652, 246 Pac. 1049).

The contrary reasoning of the Supreme Court of California can be stated as follows:

1. The liability of the directors of a corporation to its creditors and stockholders for moneys embezzled or misappropriated by its officers is not a common-law liability, but existed in California solely by virtue of the now repealed constitutional provision.

2. It is a rule of wide application, which had been settled in California for many years before petitioner's assignor extended credit to Getz Bros. & Company, that, where a right is created solely by a statutory or constitutional provision, the repeal of such provision extinguishes all rights of action under it which have not been reduced to final judgment, unless the repealing measure contains a saving clause.

3. Under the foregoing principles, petitioner's cause of action, being an inchoate right not perfected by final judgment, is extinguished by the repeal of the constitutional provision on which it was based, *unless* the giving of such effect to the repeal would impair the obligation of a contract in violation of the state and federal constitutions.

4. The extinction of petitioner's claim by the repeal is not an unconstitutional impairment of contract because:

a. The "contract" contained *first* the terms specifically set out in section 3 of article XII, respecting directors' liability, *second* the expressly reserved power of repeal in section 1 of that article, and *third* the pertinent rules of law as settled by the Supreme Court of the state prior to the mak-

ing of the contract. *Before* the extension of credit by petitioner's assignor, and, therefore, *prior* to the making of the "contract" relied on, the State Supreme Court had twice specifically decided that a pending cause of action for directors' liability, *whether penal or contractual,* is extinguished by repeal of the law creating it, unless there is a saving clause (*Moss v. Smith,* 171 Cal. 777, 786-790, 155 Pac. 90; *Freeman v. Glenn County Telephone Co.,* 184 Cal. 508, 510, 194 Pac. 705, both of which cases involved directors' liability formerly imposed by section 309 of the Civil Code). Under this rule of law, coupled with the expressly reserved power of repeal, petitioner's "contract" is the same as if the constitutional provision for directors' liability had provided, in so many words, at the time of the extension of credit, that a subsequent repeal of such provision without a saving clause would extinguish all causes of action not reduced to final judgment. [This conclusion, we submit, is supported by *First, Second* and *Third* of our argument.]

b. The extinction of the cause of action by the repeal, even apart from the express decisions as to the effect of repeals on directors' liabilities, is only a natural consequence of a long settled rule (proposition 2, supra, regarding the effect of repeals on liabilities unknown at common law), as applied to a contingency provided for in the "contract" itself; namely, the exercise of the expressly reserved power of repeal. This power, being sufficient to sustain the repeal itself, as against the

impairment of contract clause, must be able to sustain a natural and ordinary consequence of such repeal. The extinction of the cause of action is only the withdrawal, pursuant to the reserved power, of a privilege of suit created by the constitution of the state. [This conclusion, we submit, is supported by *First, Second* and *Fourth* of our argument.]

The first three of the foregoing points decided by the Supreme Court of California are not questioned by the petitioner. The correctness of the fourth is the question in the case.

SUMMARY OF ARGUMENT.

It follows from rules of law announced by the Supreme Court of California, and not questioned by the petitioner (points 1 to 3 in our summary of that court's opinion), that the repeal extinguished the cause of action if the state had power to extinguish it. The first five points in our argument are to show that the state had that power; in other words, that the extinction of the cause of action was not an unconstitutional impairment of contract. The sixth point has to do with two or three incidental questions raised by petitioner.

[*First*] It is, we submit, perfectly clear, as the Supreme Court of California decided, that the parties "contracted" in contemplation of the reserved power of repeal in the constitution of the state. In other words, if the reserved power is material (and we later show how and why it is material) it is a part of the contractual arrange-

ment relied upon by petitioner (*Sherman v. Smith*, 1 Black 587, 592, 593, and cases cited infra).

[*Second*] It is likewise clear that there can be no constitutional objection to the withdrawal by the state of a contractual right or privilege granted by its laws, or even to the destruction of an express contract, if the power so to do is properly reserved to the state (*Owensboro v. Cumberland Telephone Co.*, 230 U. S. 58, 74, and cases cited infra).

[*Third*] From the foregoing principles it follows that, if at the time petitioner's assignor extended credit to Getz Bros. & Company, the constitutional provision for directors' liability had contained an express proviso that its repeal without a saving clause would extinguish all causes of action under it which had not been reduced to final judgment, there would have been nothing unconstitutional in the extinction by repeal of petitioner's cause of action. In legal effect, we submit, the case before the court is no different from this hypothetical case. Before petitioner's contract was made, the Supreme Court of California (as we indicated in summarizing its opinion in the case at bar) had twice decided that the repeal without a saving clause of a law imposing upon directors a liability unknown at common law would extinguish pending causes of action upon such liability, *regardless of whether the liability was penal or contractual* (*Moss v. Smith*, 171 Cal. 777, 786-790, 155 Pac. 90; *Freeman v. Glenn County Telephone Co.*, 184 Cal. 508, 510, 194 Pac. 705, and infra *Third* B, for other cases applying the same general principle).

This court has decided that

> "where we come to consider a contract arising from a state law or ordinance, we will treat it as if there was embodied in its text the settled rule of law which existed in the state at the time the state action relied upon as a contract was taken" (*Ennis Water Works v. Ennis*, 233 U. S. 652, 657-658; see also *Warburton v. White*, 176 U. S. 484, 495; *Louisiana v. Pilsbury*, 105 U. S. 278, 294-295, and cases cited infra).

Petitioner's "contract," therefore, contained (1) the provision for directors' liability in section 3 of article XII; (2) the expressly reserved power of repeal in section 1 of the same article, and (3) the settled law of the state as to the consequences of the contingency of the exercise of this power of repeal. When petitioner's assignor extended his credit to the corporation and entered into the "contract" for the liability of the directors, he therefore, in legal effect, agreed that the reserved power of repeal was a part of the "contract" and that its exercise without a saving clause would extinguish any rights under the "contract" which had not been reduced to judgment.

We submit, therefore, that in granting respondent's motion to dismiss the appeal the Supreme Court of California did not give the repealing measure a "retroactive construction", as petitioner so often says (Petition for Certiorari, pp. 6, 17, 29; Supplement to Petitioner's Brief, pp. 1, 8), but, on the contrary, gave to an important provision of the "contract" the only effect it possibly could have had.

[*Fourth*] Even independently of the matters mentioned in *Third*, we submit that the decision of the Supreme Court of California does no more than properly

give effect to the reserved power of repeal. That power, we submit, enables the state to affect, by amendatory and repealing measures, private rights created by the corporation laws, to the same extent as if the Federal Constitution contained no prohibition against state laws impairing the obligation of contract. This, of course, does not mean that the reserved power can be made an excuse for an oppressive disturbance of property rights. Its definite limits are later mentioned; for the present it is enough to say that, as we contend, the history of the doctrine and the decisions of this court under it show that the petitioner's privilege to sue, a privilege created by the state, is the very sort of thing over which the reserved power was intended to preserve the state's control.

The reserved-power provisions were adopted by the states pursuant to the suggestion in the concurring opinion of Justice Story in the *Dartmouth College Case* (4 Wheat. 518) for the specific purpose of preserving the power to control private rights created by the corporation laws as against claims that the impairment of contract clause placed such rights beyond state control (*Greenwood v. Freight Co.*, 105 U. S. 13, 19-21, and cases cited infra).

There are many cases in which this court has, by reference to the reserved power, sustained state legislation affecting private rights and past transactions which, except for the reserved power, would have been unconstitutional (*Sherman v. Smith*, 1 Black, 587, and cases cited infra). Indeed, so far as the rights of the corporation or its stockholders are concerned, petitioner admits the existence of this principle (Petition for Certiorari, pp. 8-9,

point 6, b), but contends that contract rights of third persons are subject to a different rule. We submit, however, that so far as these rights are created by the corporation laws, there is no such distinction either in principle or under the authorities (*United States v. Union Pacific R. Co.*, 160 U. S. 1, 36-37, 49, and cases cited infra).

The reserved power is, of course, not without limit; "sheer oppression and wrong cannot be inflicted" under the guise of amendment or repeal (*Shields v. Ohio*, 95 U. S. 319, 324-325). *But it is not oppression or wrong, we submit, for the state to retain, through the reserved power, control of that which the state has granted.* To use an illustration employed by Justice Field in *The Railroad Tax Cases* (C. C. Cal.), 13 Fed. 722, 755 (appeal dismissed 116 U. S. 138), the state, under a reserved power, can repeal the charter of a railroad company because it granted the charter, but it cannot, under the reserved power, take away the rails or cars because it did not grant them. The present situation is comparable to the charter rather than to the cars or rails, because the circumstance that the plaintiff's claim is "contractual" does not alter the fact that it was granted by the state constitutional provision (*Christopher v. Norvell*, 201 U. S. 216, 228, quoted infra). This, indeed, is evident from the unquestioned fact that no such liability as that in suit existed at common law.

It should be noted that, where the state attempts to interfere with rights and property not granted by the state, it is ordinarily the Fourteenth Amendment rather than the impairment of contract clause which protects the owner. The reserved power of amendment and repeal

cannot validate state action of this kind, because the action is wholly unrelated to any normal or legitimate purpose of any amendatory or repealing measure. It is, therefore, not within the contemplation of the reserved power, but is "sheer oppression and wrong," and as such is forbidden by the Fourteenth Amendment* (*Chicago, Milwaukee, etc. R. Co. v. Wisconsin*, 238 U. S. 491, 501-502; *Noble State Bank v. Haskell*, 219 U. S. 104, 110; *Calder v. Michigan*, 218 U. S. 591; *Stanislaus County v. San Joaquin etc. Co.*, 192 U. S. 201, 213; *New York etc. R. Co. v. Bristol*, 151 U. S. 556, 568).

The application of the foregoing principles to the case at bar is further supported by the following considerations:

1. The reserved power necessarily gives something more than the mere right to change the law for the future, because, as to the future, such right would exist without any express reservation. Unless the reserved power be given a meaning such as we claim for it, its presence in the constitution would be unnecessary, perhaps meaningless. The courts do not attribute an idle purpose to a law-making body, be it the people or the legislature (*Blake v. McClung*, 172 U. S. 239, 260-261).

2. The California constitution contains "the broadest possible statement of the reserved power" (*Melaven v. Schmidt*, 34 N. M. 443, 283 Pac. 900, 901, involving a

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*Parenthetically, we point out that no claim under the Fourteenth Amendment was put forward in the Petition for Certiorari or is made in petitioner's brief. Such a claim, if now made, should not be considered (*Citizens' Savings Bank of Owensboro v. Owensboro*, 173 U. S. 636; *Gunning v. Cooley*, 281 U. S. 90, 98). But, if the Fourteenth Amendment could be considered, we submit there is nothing arbitrary or unreasonable in the extinction of the petitioner's cause of action by the repeal. On the contrary, as is herein shown, the "contract" contemplated and provided for the possibility of repeal and the consequent extinction of the cause of action.

constitutional provision in similar language, and cases cited infra). It is not limited to charters, but extends to "all laws * * * concerning corporations."

3. If the meaning of the reserved power is in doubt, every intendment is in favor of the decision below (1) because the reserved power must be construed in favor of the state (*Pearsall v. Great Northern R. Co.*, 161 U. S. 646, 664; *Charles River Bridge v. Warren Bridge*, 11 Pet. 420), and (2), because all presumptions favor the constitutionality of laws (*Fletcher v. Peck*, 6 Cranch, 87, 128; *Whitney v. California*, 274 U. S. 357, 371).

We point out in leaving this subject that the general proposition that the state, under the reserved power, had the right to repeal the provision for the constitutional liability of directors with the same effect as if there were no impairment of contract clause in the Constitution of the United States, sustains the decision of the Supreme Court of California in still another way. The existence of a power, of course, includes the right to exercise that power and to bring about by such exercise the natural consequences thereof (*Railroad Co. v. Georgia*, 98 U. S. 359, 365; *Lewis Publishing Co. v. Morgan*, 229 U. S. 288, 314). One of the ordinary consequences of any repeal, without a saving clause, of a law creating a liability unknown at common law is the extinguishment of claims under such liability, if they have not been reduced to judgment (infra, *Third, B*, and *The Assessors v. Osbornes*, 9 Wall. 567, 575). Any constitutional objections which otherwise might be made to the application of this ordinary rule to the liability involved in this case are met by the reserved power, because if the reserved power can sustain the repeal, as we submit it certainly does,

it must be able to sustain the ordinary consequences thereof.

[*Fifth*] We submit that none of the cases cited by petitioner dealing with the repeal of stockholders' liability laws (Supplement to Petitioner's Brief, pp. 9-12) make against the conclusions for which we contend. In this case, as we have shown, the rule as to the possible extinction of directors' liability by repeal of the law creating it, was settled in California long before the "contract" in suit was made, and that rule was a term of the "contract". None of the cases cited by petitioner involved or mentioned any comparable situation. Furthermore, in none of the decisions of this court which are cited by the plaintiff was there any mention or consideration of a reserved power of repeal. Indeed, as we later show, *Hawthorne v. Calef*, 2 Wall. 10, which is the first authority cited by the plaintiff, and the case on which the later cases cited by him rely, *involved an incorporating act which specifically provided that the general law containing the reserved power of amendment and repeal "shall not extend or apply to the Company hereby incorporated"* (Laws of Maine, 1836, c. 227, sec. 9, p. 313).

[*Sixth*] There are certain questions of state law argued by petitioner and referred to infra. These will not, we submit, be reviewed by this court.

ARGUMENT.

The points mentioned in the summary are supported in the following pages by quotations from and citations of additional authorities. Except in the headings, we do not repeat matters set forth in the summary.

FIRST: THE POWER EXPRESSLY RESERVED BY THE CONSTITUTION OF CALIFORNIA TO REPEAL ALL LAWS CONCERNING CORPORATIONS WAS A PART OF THE IMPLIED CONTRACTUAL ARRANGEMENT RELIED UPON BY PETITIONER.

In *Covington v. Kentucky*, 173 U. S. 231, this court said (p. 238):

> "The act of 1886 was passed subject to the provision in a general statute of Kentucky, above referred to, that all statutes 'shall be subject to amendment or repeal at the will of the legislature, unless a contrary intent be therein plainly expressed.' If that act in any sense constituted a contract between the city and the Commonwealth, the reservation in an existing general statute of the right to amend or repeal it was itself a part of that contract."

This passage was quoted with approval by the court in *Stanislaus County v. San Joaquin etc. Co.*, 192 U. S. 201, 212-213, dealing with the reserved power of amendment and repeal in the California constitution of 1849.

In this connection we also refer to

Calder v. Michigan, 218 U. S. 591, 598-600;
Missouri Pacific R. Co. v. Kansas, 216 U. S. 262, 274-275;
United States v. Union Pacific R. Co., 160 U. S. 1, 36-37;
Louisville Water Co. v. Clark, 143 U. S. 1, 14-15;
Chesapeake and Ohio R. Co. v. Miller, 114 U. S. 176, 189;
Greenwood v. Freight Co., 105 U. S. 13, 19-21;
The Sinking-Fund Cases, 99 U. S. 700, 720-721;
Shields v. Ohio, 95 U. S. 319, 324;
Miller v. The State, 15 Wall. 478, 492-499;

Pennsylvania College Cases, 13 Wall. 190, 212-214; *Sherman v. Smith*, 1 *Black*, 587, 592-593.

And, similarly, as showing the same rule which was settled in California long before the State Supreme Court applied it in this case, we quote *Market Street Ry. Co. v. Hellman* (1895), 109 Cal. 571, 584, 42 Pac. 225:

> "The objection that the proceedings under which the consolidation was had were violative of the constitutional rights of nonconsenting stockholders does not call for extended comment.
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> • • • • • • • • •
>
> When an individual becomes a stockholder in a corporation, it is with the implied assent on his part to the right of the legislature to alter and amend the law within the scope of the constitutional provision, and is as binding upon him as a contract to like effect of his own making would be.
>
> Authorities drawn from states in which no such legislative power over corporations is reserved are without application to cases in this state."

SECOND: THE STATE HAS POWER TO WITHDRAW CONTRACTUAL RIGHTS OR PRIVILEGES GRANTED BY IT, SUCH AS THE PRIVILEGE OF SUIT HERE CLAIMED BY PETITIONER, AND MAY EVEN DESTROY AN EXPRESS CONTRACT, PROVIDED ONLY THE POWER TO DO SO IS CLEARLY RESERVED.

A repealable contract obviously cannot be "impaired" by exercise of the power of repeal (*Missouri Pacific R. Co. v. Kansas*, 216 U. S. 262, 274-275; *Hammond Packing Co. v. Arkansas*, 212 U. S. 322, 346; *Citizens' Savings Bank of Owensboro v. Owensboro*, 173 U. S. 636, 644).

As was said in the *Missouri Pacific* case (216 U. S. 274-275):

> "As it is not denied that the asserted charter right was held subject to the power of the State to repeal, alter or amend, it follows that the proposition amounts simply to saying that an irrepealable contract right arose from a contract which was repealable. *Hammond Pacific Co. v. Arkansas*, 212 U. S. 322, 345. Stating the contention in a different form, the same contradiction becomes apparent. As the argument concedes the existence of the legislative power to repeal, alter or amend, and as it is impossible to assume that a legislative act has impaired a contract without by the same token declaring that such act has either repealed, altered or amended, hence *the proposition relied upon really contends that the contract has been unlawfully impaired by the exercise of a power which it is conceded could lawfully repeal the contract.* And, of course, this reason is controlling, irrespective of the scope of the alleged charter right, since whatever be the extent of the right conferred it was subject to the reserved power." [Italics ours throughout the brief, unless otherwise indicated.]

In *Owensboro v. Cumberland Telephone Co.*, 230 U. S. 58, where the question was whether a franchise to use the streets could be repealed by the municipality, the court said (p. 74):

> "That the right may be reserved to destroy a contract may be conceded; but when such a right is claimed, it must be clear and explicit."

THIRD: THE CONTINGENCY OF REPEAL, WITH A CONSEQUENT EXTINCTION OF PETITIONER'S CAUSE OF ACTION, WAS CONTEMPLATED AND PROVIDED FOR IN THE "CONTRACT" RELIED ON BY PETITIONER. LONG BEFORE THE EXTENSION OF CREDIT BY HIS ASSIGNOR, THE SUPREME COURT OF CALIFORNIA HAD DECIDED THAT PENDING CAUSES OF ACTION UPON A DIRECTOR'S LIABILITY, UNKNOWN AT COMMON LAW, ARE, UNLESS EXPRESSLY SAVED, EXTINGUISHED BY THE REPEAL OF THE LAW CREATING THE LIABILITY, REGARDLESS OF WHETHER THE LIABILITY IS PENAL OR CONTRACTUAL. UNDER THE SETTLED RULE OF THIS COURT THESE DECISIONS WERE A PART OF THE "CONTRACT" RELIED UPON BY PETITIONER.

A. The decisions of this court, under which the preexisting state law is a part of the statutory contract.

In *Warburton v. White*, 176 U. S. 484, this court said (p. 495):

> "It is claimed that where a contract is asserted to have been impaired by a subsequent statute it is the duty of this court to determine for itself the nature and extent of the contract, where the subsequent legislation has been by the decision of the court held operative upon or enforced against the alleged contract rights. The doctrine is elementary, but the principle which it embodies is subject to a well-settled qualification, which is, that *where it is asserted that a contract has been entered into on the faith of the state laws, existing at the time when it was made, the construction of such laws, which was settled at the time of the making of the contract, by the court of last resort of the State, will be adopted and applied by this court in considering the nature of the contract right relied upon.*"

To the same effect are:

Ennis Water Works v. Ennis, 233 U. S. 652, quoted supra;

Gulf and Ship Island Railroad Co. v. Hewes, 183 U. S. 66, 71-72;
German Bank v. Franklin County, 128 U. S. 526, 538-539;
Louisiana v. Pilsbury, 105 U. S. 278, 294-295;
Taylor v. Ypsilanti, 105 U. S. 60, 71;
Christian Union v. Yount, 101 U. S. 352, 357;
Fairfield v. County of Gallatin, 100 U. S. 47, 54.

B. The decisions of the Supreme Court of California, under which the extinction of petitioner's cause of action by the repeal was a contingency contemplated by the contract.

In *Moss v. Smith,* 171 Cal. 777, 155 Pac. 90—decided January 20, 1916; the "contract" in the case at bar was created in 1923—the plaintiff brought suit against directors of the Ocean Shore Railway Company under section 309 of the Civil Code which, at the time, made directors liable for participating in the creation of debts in excess of the subscribed capital stock. The trial court sustained a demurrer to the complaint on the ground that, after the creation of the excessive indebtedness, and after the commencement of the suit, the provision of section 309 making directors liable on this account had been repealed by the Public Utilities Act as to public service corporations, the Ocean Shore Railway Company being a corporation of that kind. In holding that the repeal, without a saving clause, extinguished all pending causes of action, *whether the liability was considered penal or remedial,* and that the demurrer was, therefore, properly sustained, the court said (171 Cal. 787-789):

> *"That this change in the law destroyed absolutely appellants' right further to prosecute their action, whether that action be in its nature penal or remedial,*

no possible doubt can be entertained. True it is that the new law does not repeal sections 309 and 456 of the Civil Code *in toto,* but it does repeal them absolutely so far as they apply to that class of public utility corporations to which the Ocean Shore Railway Company belongs, and it contains no clause saving pending litigation or imperfect and inchoate rights. The right of action against these directors conferred by section 309 was a statutory right pure and simple, having no foundation in contract, nor any existence at common law (*National Bank v. Dillingham,* 147 N. Y. 603, [49 Am. St. Rep. 692, 42 N. E. 338]). *'There can be no question in this state of the power of the legislature to destroy such inchoate and unvested rights,* for section 327 of the Political Code expressly declares that 'any statute may be repealed at any time, except when it is otherwise provided therein. Persons acting under any statute are deemed to have acted in contemplation of this power of repeal.' Says Thompson (2 Thompson, Corp. 2nd ed., sec. 1331): 'Courts are not required to adopt the theory that these statutes are penal, to justify the holdings that the repeal of such a statute without reservation destroys any unenforced rights of a creditor. Such holdings can be justified on the equally sound doctrine that the repeal of a statute which gives a cause of action destroys the right, and any pending action based on such statute is abated by such repeal.' *Therefore it is that we say that it does not become of vital consequence in this consideration whether the statute be viewed as penal or remedial.* The principle is that declared in *Curran v. Owens,* 15 W. Va. 208, in the following language: 'A right of action which does not exist at common law but depends solely upon statute falls with a repeal of the statute, without a saving clause,

unless that right has been carried into judgment.' Such is the decision of this court in *Napa State Hospital v. Flaherty*, 134 Cal. 315 [66 Pac. 322]. * * * It is a rule of almost universal application that, where a right is created solely by a statute, and is dependent upon the statute alone, and such right is still inchoate, and not reduced to possession, or perfected by final judgment, the repeal of the statute destroys the remedy unless the repealing statute contains a saving clause. * * * And to the same effect are all of the cases in this state [citing cases]. Says Mr. Justice Gray in *New London Northern R. R. Co. v. Boston, etc., R. R. Co.*, 102 Mass. 386: 'The conclusive answer to this argument is, that a statute which wholly repeals an earlier one, either expressly or by implication, without any saving clause, makes it ineffectual to support any proceedings, whether not yet begun, or pending at the time of its passage, and not already prosecuted to final judgment vesting absolute rights. The books are so full of cases illustrating this principle that the only difficulty is in making a selection.' Without further multiplying quotations it may be said that the principle is of universal application'' [citing many cases].

The same ruling with respect to a repealing measure affecting the same statute (Civil Code sec. 309) was made in *Freeman v. Glenn County Telephone Co.* (decided December 20, 1920), 184 Cal. 508, 194 Pac. 705. The court quoted and followed *Moss v. Smith*, supra.

In *Willcox v. Edwards* (decided March 30, 1912), 16 Cal. 465, 123 Pac. 276, the same principle was applied to the repeal of a constitutional provision. That action was based on section 26 of article IV of the constitution, which, prior to November 3, 1902, and when the action of

Willcox v. Edwards was commenced, authorized the recovery of money paid on contracts for the sale of corporate stock on margin. The Supreme Court of California, in holding that a right of action under the constitutional provision did not survive its repeal without a saving clause, said as part of a thorough discussion of the general doctrine (162 Cal. 463-464, 467):

> "The court, however, is convinced that the right to sue under the section as it existed when the contract was made did not survive the repeal of that part of the constitution. To uphold that doctrine we would be compelled to conclude that the right to sue for the recovery of money paid under a void contract for the purchase of stock was a vested right depending upon a *quasi* contract for the repayment of the money by the broker which arose by operation of law from the very terms of the constitutional provision as it existed when the void contract was made. Such a rule is not, we think, supported by the best reasoning nor by the weight of authority. We are here concerned with the *right of action* given by the section as it stood originally but omitted from it upon its later readoption. Unless a vested right had arisen in favor of plaintiff's decedent prior to the amendment of the constitution without a saving clause, the privilege of bringing suit for the money paid on the margin contract was withdrawn by the repeal of the law granting it, and all pending litigation not prosecuted to final judgment fell for want of authority to maintain it. We have concluded that the privilege of bringing an action like this was taken away by the later enactment, and that makes it unnecessary to discuss the effect of this subsequent constitutional provision upon the *status* of the contract for the purchase of stock on margins. We are aware that this court has held the constitu-

tional provision giving the right to sue under the former section 26 of article IV to be not penal but remedial in its nature (*Parker v. Otis,* 130 Cal. 322 [92 Am. St. Rep. 56, 62 Pac. 571]), and therefore that an action brought under it is not barred by the statute of limitations applicable to actions 'upon a statute for a penalty or a forfeiture'; but it does not follow that being remedial the section in question confers a right that is vested before action and final judgment thereon (pp. 463-464).

* * * * * * * *

The very language of section 26 of article IV of the constitution as it existed when plaintiff's decedent entered into the contracts in question indicates, we think, an intention not to vest a right to the return of his money in one who entered into a forbidden arrangement with a broker for the purchase of stocks on margin. He was given the power to sue for the money, but there is no declaration or implication that he was entitled to it before it was recovered by such suit. The very terms of the section gave to him an inchoate right and as we have seen such rights become vested only when reduced to final judgment" (p. 467, italics by the court).

Other cases, decided prior to the extension of credit by petitioner's assignor, in which the Supreme Court of California had laid down the same general principle, are:

People v. Bank of San Luis Obispo (1910), 159 Cal. 65, 67, 112 Pac. 866 (repeal of statutory authority for decree declaring insolvency of a bank);

Wheeler v. County of Plumas (1906), 149 Cal. 782, 785-786, 87 Pac. 802 (repeal of statute giving counties power to license for purposes of revenue;

approved in *Flanigan v. Sierra County*, 196 U. S. 553, involving the same statute);

Napa State Hospital v. Flaherty (1901), 134 Cal. 315, 317-318, 66 Pac. 322 (repeal of statute giving trustees of insane asylums right of action against father for support of insane adult son);

First National Bank v. Henderson (1894), 101 Cal. 307, 309-310, 35 Pac. 899 (repeal during pendency of suit of statute requiring bank to file published statements, held to overcome defense based on statute);

Lamb v. Schottler (1880), 54 Cal. 319, 322-326 (proceedings of Appraising Board are annulled by repeal of statute. This case contains discussion and statement of rule frequently approved in later California cases);

McMinn v. Bliss (1866), 31 Cal. 122, 126 (repeal of forcible entry and detainer statute).

The reserved power of repeal was one of the grounds of decision in the director's liability cases (*Moss v. Smith* and *Freeman v. Glenn County Telephone Company*, supra). The California court had in many other cases invoked the reserved power in support of changes in the corporation laws which affected contract rights.

Matter of College Hill Land Association (1910), 157 Cal. 596, 598, 108 Pac. 681 (statute authorizing dissolution on two-thirds vote of *stock* upheld as against stockholders who acquired their stock under statute requiring two-thirds vote of the *stockholders*);

McGowan v. McDonald (1896), 111 Cal. 57, 66, 43 Pac. 418 (statutory amendment after acquisition of

stock increasing stockholders' liability. The facts were similar to *Sherman v. Smith*, 1 Black, 587);

Market Street Railway Co. v. Hellman (1895), 109 Cal. 571, 42 Pac. 225 (statutory amendment for consolidation of corporations sustained under reserved power);

Spring Valley Water Works v. San Francisco (1881), 61 Cal. 3, 5; affirmed *Spring Valley Water Works v. Schottler*, 110 U. S. 347 (statute transferring power to fix water rates from commissioners selected in part by Water Company to Board of Supervisors).

FOURTH: INDEPENDENTLY OF THE POINT LAST MADE, THE EXTINCTION OF PETITIONER'S CAUSE OF ACTION BY THE EXERCISE OF THE RESERVED POWER OF REPEAL WAS WITHIN THE AUTHORITY OF THE STATE AND WAS NOT AN UNCONSTITUTIONAL IMPAIRMENT OF CONTRACT.

A. The effect of the reserved power is to enable the state to pass such amendatory and repealing laws relative to corporations as might be passed if the federal constitution contained no prohibition against state laws impairing the obligation of contract.

In support of the principle stated in the heading, we refer first to the history of the doctrine and then to decisions of this court in which it has been applied.

1. The reserved power provisions were adopted by the states, pursuant to the suggestions in the concurring opinion of Justice Story in the Dartmouth College Case, for the specific purpose of preserving the power to control private rights created by the corporation laws against the claim that the impairment of contract clause placed such rights beyond state control.

In *Looker v. Maynard*, 179 U. S. 46, this court said (pp. 51-52):

"By the decision in the leading case of *Dartmouth College v. Woodward*, 4 Wheat. 518, it was established that a charter from the State to a private corporation created a contract, within the meaning of the clause in the Constitution of the United States forbidding any State to pass any law impairing the obligation of contracts; and consequently that a statute of the State of New Hampshire, increasing the number of the trustees of Dartmouth College as fixed by its charter, and providing for the appointment of a majority of the trustees by the executive government of New Hampshire, instead of by the board of trustees as the charter provided, was unconstitutional and void.

Mr. Justice Story, in his concurring opinion in that case, after declaring that in his judgment it was 'perfectly clear that any act of a legislature which takes away any powers or franchises vested by its charter in a private corporation, or its corporate officers, or which restrains or controls the legitimate exercise of them, or transfers them to other persons, without its assent, is a violation of the obligations of that charter,' took occasion to add: 'If the legislature mean to claim such an authority, it must be reserved in the grant.' 4 Wheat. 712.

After that decision, many a State of the Union, in order to secure to its legislature the exercise of a fuller parliamentary or legislative power over corporations than would otherwise exist, inserted, either in its statutes or in its constitution, a provision that charters thenceforth granted should be subject to alteration, amendment or repeal at the pleasure of the legislature."

To the same effect with reference to the history and purpose of the reserved power are:

Citizens' Savings Bank v. Owensboro, 173 U. S. 636, 651;

Pearsall v. Great Northern R. Co., 161 U. S. 646, 660, et seq.;

Greenwood v. Freight Co., 105 U. S. 13, 19-21;

Miller v. The State, 15 Wall. 478, 495-498;

Tomlinson v. Jessup, 15 Wall. 454, 458.

The Supreme Court of California has pointed out that the reserved power was placed in the California constitution for the specific purpose of enabling the state to avail itself of these principles; in the language of the court, its purpose was "to neutralize the effect of the Dartmouth college doctrine" (*Peterson v. Ball* (1931), 211 Cal. 461, 473-474, 296 Pac. 291).

2. This court, by reference to the reserved power, has sustained legislation affecting private rights and past transactions which, except for the reserved power, would have been unconstitutional.

a. Cases involving rights of the corporation or stockholders.

The cases already cited show that, under the reserved power, a corporate charter can be repealed which otherwise, under the *Dartmouth College Case,* would be irrevocable. Likewise, as was decided in the *Dartmouth College Case,* the charter method of corporate government cannot be materially changed by subsequent legislation. But, under the reserved power, the legislature can, by subsequent act, confer upon a subscriber to a certain block of the stock of a railroad, the right to name a majority as distinguished from a minority of the Board of Directors (*Miller v. The State,* 15 Wall. 478), or it can alter the relative powers of the stockholders by a statute permitting cumulative voting (*Looker v. Maynard,* 179 U. S. 46).

If the law of incorporation prescribes the taxes to which the corporation or its stockholders shall be subject, a contract results, which cannot be impaired by subsequent legislation raising the rate of taxation or imposing additional taxes (*State Bank of Ohio v. Knoop,* 16 How. 369, and many cases cited in *Pearsall v. Great Northern R. Co.,* 161 U. S. 646, 662-663). But, under the reserved power, the exemption can be repealed or additional taxes imposed (*Covington v. Kentucky,* 173 U. S. 231, 238; *Keokuk etc. R. Co. v. Missouri,* 152 U. S. 301, 306; *Louisville Water Co. v. Clark,* 143 U. S. 1, 12, et seq.; *Chesapeake and Ohio R. Co. v. Miller,* 114 U. S. 176, 188-189). Such a repeal is proper even though the original statute may have provided that the tax scheme therein contained should continue for a specified number of years (*Citizens' Bank of Owensboro v. Owensboro,* 173 U. S. 636), and it is good as against stockholders who bought their stock on the faith of the original enactment before the repeal. In *Tomlinson v. Jessup,* this court said (15 Wall. 454, 458):

> "And it may be equally true, as stated by counsel, that the exemption from taxation added greatly to the value of the stock of the company, and induced the plaintiff to purchase the shares held by him. But these considerations cannot be allowed any weight in determining the validity of the subsequent taxation. The power reserved to the State by the law of 1841 authorized any change in the contract as it originally existed, or as subsequently modified, or its entire revocation. The original corporators, or subsequent stockholders, took their interests with knowledge of the existence of this power, and of the possibility of its exercise at any time in the discretion of the legislature."

Again, it is settled that, in the absence of a reserved power, stockholders' liability cannot be imposed upon existing stockholders or with respect to stock of existing corporations (*Steacy v. Little Rock etc. R. Co.*, 5 Dill. 348, Fed. Cas. No. 13,329; *Norris Safe & Lock Co. v. Weaver*, 81 Ore. 670, 160 Pac. 807). But the rule is otherwise under a reserved power. So, in *Sherman v. Smith*, 1 Black, 587, a statute, organizing a bank in which Sherman became a stockholder, provided that the stockholder should *not* be subject to any individual liability for the bank's debts. In sustaining a repeal of the charter provision the court said (p. 593):

> "Now, the 32nd section, which reserved to the Legislature the power to alter or repeal the act, by necessary construction, *reserved the power to alter or repeal all or any one of these terms and conditions, or rules of liability, prescribed in the act. The articles of association are dependent upon, and become a part of, the law under which the bank was organized, and subject to alteration or repeal the same as any other part of the general system.*"

To the same effect is *McGowan v. McDonald*, 111 Cal. 57, 43 Pac. 418, cited by the Supreme Court of California in the case at bar (R. p. 52). In that case the court said (p. 66):

> "It is objected, however, that if the provisions of the code and constitution are applicable they impose obligations upon appellants for which they were not liable when they became stockholders, and are in conflict with that provision of the constitution of the United States which inhibits the states from passing laws impairing the obligation of contracts, and are therefore as to them unconstitutional and of no effect.

> The answer to this objection is that the constitution of 1849 provided 'Corporations may be formed under general laws, but shall not be created by special act, except for municipal purposes. All general laws and special acts passed pursuant to this section may be altered from time to time, or repealed' (Const., art. IV, sec. 31).
>
> Under the authority thus conferred both the legislature and the people had power to change the law in regard to the liability of stockholders, without violating any provision of the constitution of the United States."

Similarly, under the reserved power, but not otherwise, the legislature can prescribe service rates, where none were prescribed in the original charter (*Shields v. Ohio,* 95 U. S. 319, 324), or can change rates fixed by an earlier law (*Stanislaus County v. San Joaquin etc. Co.,* 192 U. S. 201, 212, 213; *Peik v. Chicago & Northwestern R. Co.,* 94 U. S. 164); or can change the rate-fixing authorities (*Spring Valley Water Works v. Schottler,* 110 U. S. 347; *Spring Valley Water Works v. Bartlett* (C. C. Cal.), 16 Fed. 615; *Spring Valley Water Works v. San Francisco,* 61 Cal. 3); or can require a railroad company to maintain its own telegraph line, despite a provision in the incorporating statute permitting the railroad company to arrange with telegraph companies for the maintenance thereof (*United States v. Union Pacific R. Co.,* 160 U. S. 1, 36).

More examples could be given, but the foregoing cases illustrate the principle that the reserved power authorizes the legislature to affect contract rights which otherwise, by reason of the impairment of contract clause, would be beyond its control.

b. Cases involving contractual rights of third persons.

We mentioned that petitioner admits (Petition for Certiorari, pp. 8-9, point 6, b) that contractual rights of the corporation and stockholders can be affected under the reserved power, but that he argues that the rule is different as to rights of third persons. This distinction fails in the present case, because the California constitutional provision making the directors liable for moneys embezzled by corporate officers *gave the same cause of action to stockholders as it extended to creditors.* Clearly, therefore, if the reserved power as applied to the provision in suit can (in accordance with petitioner's admission) justify the extinction by repeal of *stockholders'* causes of action against the directors, it must, by the same token, justify the extinction of the *creditor's* cause of action.

Furthermore, we submit, there is no logical ground for petitioner's distinction between contractual rights of a corporation or stockholders and contractual rights of third persons. It is clear that the state can, under the reserved power, annul its own direct contract with a corporation. It should much more clearly be able to cut off an incidental and unperfected right arising out of a contractual relation in favor of a third person which has been created by implication of the corporation laws. We submit that the fundamental principle operates in the same way, regardless of whether the rights concerned are those of the corporation or its stockholders, or of third persons.

In *United States v. Union Pacific R. Co.*, 160 U. S. 1, mentioned supra, the Union Pacific had been subsidized under the transcontinental railway legislation of the '60's (July 1, 1862, 12 Stats. 489; July 2, 1864, 13 Stats. 356).

Under the 19th section of the act of 1862 and the 4th section of the act of 1864, the railroad was permitted to arrange with certain telegraph companies for telegraph lines along the railroad route. Pursuant to this express authority it made contracts with the Western Union Telegraph Company, which thereby acquired control of the telegraph business along the railroad. In 1888, pursuant to provisions in the earlier statutes reserving the right of amendment and repeal, Congress required all railroads which had been constructed under subsidy to maintain their own telegraph lines (August 7, 1888, 25 Stats. 328). The United States brought suit against both the railroad company and the telegraph company to compel compliance with the new law. The defense was that because of the contracts made between the defendants on the faith of the earlier law, the statute of 1888 was invalid as to them. This court overruled that contention and said (pp. 36-37):

> "*Indeed, no arrangement of the character specified could have been made, except in full view of the power reserved to add to, alter, or amend the act that permitted it.* Although, as just stated, that power could not have been exercised, so as to divest either the railroad company or the telegraph company of property already acquired, or to disturb or annul any transaction *fully* consummated, while such arrangement was in force, it was competent for Congress to make such additions to, or such alterations or amendments of, previous statutes, as would secure the maintenance or operation by the railroad company, through its own officers and employes, of a telegraph line over and along its main line and branches.
>
> *It is of no consequence that such legislation may defeat the purpose contemplated by the parties to an*

arrangement of the character described; for they contracted, and could only have contracted, in view of the possible exercise by Congress of the power expressly reserved by it. If we should hold the addition made by the act of 1888 to the act of 1862, and the acts amendatory thereof, to be beyond the power of Congress, it would be difficult, if not impossible, to prescribe the lines within which the national legislature must keep, and beyond which it may not pass, when exerting its reserved power of adding to, altering, or amending statutes and charters of incorporation.

We have, therefore, considered the question before us just as if a contract or arrangement, between the railroad and a telegraph company, for the construction by the latter of a telegraph line on the route of the former, expressly recited the provision of the act of 1862, by which Congress reserved the power, to be exerted at any time, to add to, amend, or repeal the act which authorized such contract or arrangement.

* * * * * * * *

These principles are fully supported by former decisions, in which this court has determined the scope and effect of constitutional or statutory provisions that reserved to the legislature granting charters of incorporation, or enacting statutes under which private rights might be acquired, the power to alter, amend, or repeal such charters or statutes" (citing *Tomlinson v. Jessup, Miller v. State,* supra, and many other cases).

Further, the court said, in answer to the claims of the telegraph company (pp. 49-50):

"On behalf of the telegraph company it is contended that it was beyond the power of Congress to so legislate as 'to impair the contracts, first, that

between the United States and the several companies mentioned in the act of 1862; and, second, those between the railway company and this defendant.' We perceive no ground on which this contention can properly rest. It has already been fully examined. As we have seen, Congress in the act of 1862 expressly reserved the power not only to alter, amend, or repeal that act, but to add to its provisions. To what has already been said as to the power of Congress, under this reserved power, we may add, that the object of such reservation is to enable the legislative department to protect the public interests, and 'to preserve to the State control over its contract with the corporators, which without that provision would be irrepealable and protected from any measure affecting its obligation.' *Tomlinson v. Jessup,* 15 Wall. 454, 457, 458."

It is, we submit, clear that, if the Telegraph Company had sued the Railroad Company on the contracts, the amending statute would have been a defense to the Railroad Company. This points the close parallel between the *Union Pacific* case and the case at bar.

That the reserved power (contrary to petitioner's contention) can affect rights of third persons, as well as those of the corporation or stockholders, was also pointed out in *Looker v. Maynard,* 179 U. S. 46. In sustaining a Michigan statute permitting cumulative voting, the court cited *Miller v. State,* 15 Wall. 478, supra, and of the *Miller* decision said (179 U. S. 53-54):

"The full extent and effect of the decision are clearly brought out by the opinion of two justices who dissented for the very reason that the agreement with respect to the number of directors which the city

should elect was not a part of the charter of the company, but was an agreement between third parties, outside of and collateral to the charter, and which the legislature could not reserve the power to alter or repeal. 15 Wall. 499. That case cannot be distinguished in principle from the case at bar."

In *Schurz v. Cook*, 148 U. S. 397, the court said (p. 411):

"The corporations, mortgagees and bondholders under such circumstances acquire their rights subject to the reserved power of the legislature to enlarge or diminish the franchises conferred, and to increase or reduce the burdens thereon."

Such authorities as the foregoing, we submit, establish the principle that the state can pass any amendatory or repealing law which it otherwise could have passed under the reserved power, notwithstanding that third persons, under the prior law, have entered into contractual relations which indirectly or incidentally will be affected by the amendatory or repealing law. So, in the case at bar the state expressly reserved the power of repeal. An incidental consequence of the exercise of that power is to cut off petitioner's privilege of proceeding further with this suit, but this consequence under the circumstances is not unconstitutional. The state may exercise a right which it has expressly reserved, regardless of what the incidental result may be upon the ability of creditors to collect their claims. Thus, as we have shown, the reserved power will authorize the state to revoke a tax exemption or change a system of taxation specified in the incorporating act (*Tomlinson v. Jessup*, 15 Wall. 454, and cases cited supra). It makes no difference that the exercise of this power may

so increase the corporate burdens that the company cannot pay its outstanding debts (*Louisville Water Co. v. Clark*, 143 U. S. 1; *Union Pacific R. Co. v. Mason City & Ft. D. R. Co.*, 128 Fed. 230, affirmed 199 U. S. 160; *Appeal Tax Court of Baltimore v. The Baltimore Academy of the Visitation*, 50 Md. 437; *Storrie v. Houston City Street Railway Co.*, 92 Tex. 129, 46 S. W. 796). Similarly, if the state has reserved the right to regulate service rates, the creditors, who may have extended their credit on the faith of rates expressly provided by law, have no constitutional right to object to a change in rates; even such a change as will destroy the corporation's power to pay its debts (*Peik v. Chicago and Northwestern Railway Co.*, 94 U. S. 164; *Bondholders v. Railroad Commissioners*, Case No. 1625, 3 Fed. Cas. 846; *Attorney-General v. Railroad Companies*, 35 Wis. 425).

So, in the *Peik* case, which was affirmed by this court (94 U. S. 164), the Circuit Court said (*Piek v. Chicago and N. W. Ry. Co.* [sic], 6 Biss. 177, Fed. Case No. 11,138, 19 Fed. Cas. 625, 626):

> "It (the reserved power) became by operation of law, a part of every contract or mortgage made by the company, or by any of its numerous predecessors, under which it claims. The share and bond holders took their stock or their securities subject to this paramount condition, and of which they, in law, had notice. If the corporation, by making a contract or deed of trust on its property, could clothe its creditors with an absolute, unchangeable right, it would enable the corporation, by its own act, to abrogate one of the provisions of the fundamental law of the state."

Other authorities for the same rule are:

Calder v. Michigan, 218 U. S. 591, 598-600 (*Quo warranto* to enforce statute, passed under reserved power, repealing charter. Defendants set up bondholders' rights. "They contracted subject not paramount to the proviso for repeal * * *" (p. 599). "* * * it is a matter upon which the bondholders have nothing to say" (p. 600));

Polk v. Mutual Reserve Life Fund, 207 U. S. 310, 325-326 (amendment authorizing change of business from assessment life insurance business to life insurance of every kind);

The Pennsylvania College Cases, 13 Wall. 190, 217-221 (upholding, under reserved power, statute for consolidation of colleges affecting holders of scholarships);

C. H. Venner Co. v. United States Steel Corp. (C. C. N. Y.), 116 Fed. 1012 (amendatory act authorizing bond issue to retire stock, not unconstitutional as against stockholders);

Macon etc. R. Co. v. Stamps, 85 Ga. 1, 11 S. E. 442, 446 (statute changing charter route of railroad not unconstitutional impairment of executory contracts between railroad and construction company).

B. While the reserved power is not without limit, and "sheer oppression and wrong cannot be inflicted" under the guise of amendment or repeal (Shields v. Ohio, 95 U. S. 319, 324-325), it is not oppression or wrong for the state to retain, through the reserved power, control of that which the state granted; in this case the privilege of suit claimed by petitioner.

In the *Sinking-Fund Cases*, 99 U. S. 700, this court, after saying that, under the reserved power in the railroad acts there involved, "Congress not only retains, but has given special notice of its intention to retain, full and complete power to make such alterations and amendments of the charter as come within the just scope of legislative power," went on to say (pp. 720-721):

> "That this power has a limit, no one can doubt. All agree that it cannot be used to take away property already acquired under the operation of the charter, or to deprive the corporation of the fruits actually reduced to possession of contracts lawfully made; but, as was said by this court, through Mr. Justice Clifford, in *Miller v. The State* (15 Wall. 498), 'it may safely be affirmed that the reserved power may be exercised, and to almost any extent to carry into effect the original purposes of the grant, or to secure the due administration of its affairs, so as to protect the rights of stockholders and of creditors, and for the proper disposition of its assets'; and again, in *Holyoke Company v. Lyman* (id. 519), 'to protect the rights of the public and of the corporators, or to promote the due administration of the affairs of the corporation.' Mr. Justice Field, also speaking for the court, was even more explicit when, in *Tomlinson v. Jessup* (id. 459), he said, 'the reservation affects the entire relation between the State and the corporation, and places under legislative control all rights, privileges, and immunities derived by its charter di-

rectly from the State'; and again, as late as *Railroad Company v. Maine* (96 U. S. 510), 'by the reservation * * * the State retained the power to alter it (the charter) in all particulars constituting the grant to the new company, formed under it, of corporate rights, privileges, and immunities.' Mr. Justice Swayne, in *Shields v. Ohio* (95 U. S. 324), says, by way of limitation, 'The alterations must be reasonable; they must be made in good faith, and be consistent with the object and scope of the act of incorporation. Sheer oppression and wrong cannot be inflicted under the guise of amendment or alteration.' "

We will not repeat or extend the discussion of this subject, which is contained in the summary, because the present case does not, as we understand, require a statement of the exact limits of the reserved power. *No case, so far as we know, questions the principle that the state, under the reserved power, may withdraw a privilege which the state has granted, and that principle, we submit, is enough to sustain the decision of the Supreme Court of California in the case at bar.*

No such liability as that here asserted against respondent existed at common law. The circumstance that the liability is "contractual" does not make against the fact that it was created by the state through the constitutional provision. Thus, in *Christopher v. Norvell,* 201 U. S. 216, this court held that the liability imposed by the federal statutes upon stockholders of national banks, though "contractual" in its nature, is nevertheless solely based on the statute, and, therefore, that a married woman who became a stockholder was subject to the contractual liability, notwithstanding that under the law of Florida she

had no capacity to make a contract.* The court said (p. 228):

> "The argument made in this case in behalf of Mrs. Christopher assumes that the liability sought to be fastened upon her arises wholly out of contract; that is, out of an implied obligation, at the time her name was placed on the registry of shares and she received dividends, to contribute to the extent of the value of such shares to the payment of the debts of the bank. But that implied obligation, although contractual in its nature, could not, standing alone, be made the basis of this action. Without the statute she could not be made liable individually for the debts of the bank at all. No implied obligation to contribute to the payment of such debts could arise from the single fact that she became and was a shareholder. Her liability for the debts of the bank is created by the statute, although in a limited sense there is an element of contract in her having become a shareholder; and the right of the receiver to maintain this action depends upon, and has its sanction in, the statute creating liability against each shareholder, in whatever way he may have become such. There have been cases in which there appeared such elements of contract as were deemed sufficient, in particular circumstances, to support an action. *Concord First Nat. Bank v. Hawkins,* 174 U. S. 364, 372; *Whitman v. Oxford Nat. Bank,* 176 U. S. 559, 565, 566; *Matteson v. Dent,* 176 U. S. 521. But that fact does not justify the contention that an action upon an assessment made by the Comptroller is not based upon the statute."

*This ruling is in keeping with the meaning of "contractual" in cases of this kind. See footnote, supra p. 4.

C. The application of the foregoing principles to the case at bar is further supported by the considerations that

1. The California constitution contains "the broadest possible statement of the reserved power."

Melaven v. Schmidt, 34 N. M. 443, 283 Pac. 900, 901 (containing the quotation made in the heading);

Polk v. Mutual Reserve Life Fund, 207 U. S. 310, 325;

Stanislaus County v. San Joaquin etc. Co., 192 U. S. 201;

Hamilton Gas Light Co. v. Hamilton City, 146 U. S. 258, 271;

Greenwood v. Freight Co., 105 U. S. 13, 17.

2. The reserved power necessarily gives something more than the mere right to change the law for the future, because such right as to the future would exist without any express reservation, and the court cannot assume that the express reservation was made without any object.

In *Blake v. McClung,* 172 U. S. 239, this court, considering the qualifying words "within its jurisdiction," which appeared in the "equal protection cla[illegible] of the constitution of Virginia, said (pp. 260-261):

> "The court cannot assume that those words were inserted without any object, nor is it at liberty to eliminate them from the Constitution and to interpret the clause in question as if they were not to be found in that instrument."

The mere right to change the law for the future exists without any express reservation. As this court said in *New York Central R. Co. v. White,* 243 U. S. 188, 198:

"No person has a vested interest in any rule of law entitling him to insist that it shall remain unchanged for his benefit."

To the same effect are:

Chicago & Alton R. Co. v. Tranbarger, 238 U. S. 67, 76;

Second Employers' Liability Cases, 223 U. S. 1, 50;

Hurtado v. California, 110 U. S. 516, 532-533;

Munn v. Illinois, 94 U. S. 113, 134;

2 *Cooley's Constitutional Limitations,* 8th Ed. p. 749.

Obviously, therefore, under the principle stated in *Blake v. McClung,* supra, the express reservation must confer a broader power than would exist without it.* The power, thus enlarged by the reservation, subject to the limitations already mentioned, authorizes the state to affect past transactions. Thus, in *Miller v. The State,* 15 Wall. 478, this court, citing *Sherman v. Smith,* 1 Black 587, said (15 Wall. 495):

"* * * the provision reserving to the legislature the power to alter or repeal the general banking law became a part of the contract with every association

*Even under the general principle, unaided by any expressly reserved power, changes in the law cut off certain unperfected rights which at least seem as substantial as the petitioner's mere cause of action. Dower, for example, may be cut off by a change in the law at any time before the death of the husband (*Randall v. Kreiger,* 23 Wall. 137; *Ferry v. Spokane etc. R. Co.,* 258 U. S. 314, 320). A charter power to a corporation to consolidate with other corporations is considered to be a privilege rather than a contract, and, until it has been executed, it can be revoked, even if no power of revocation is expressly reserved (*Pearsall v. Great Northern R. Co.,* 161 U. S. 646, 672, et seq.—in this case the Minnesota constitution permitted amendment or repeal only in such manner "not destroying or impairing the vested rights of said corporation" (161 U. S. 649)). Many instances will readily suggest themselves of unperfected rights which can be cut off by exercise of the police power (*Manigault v. Springs,* 199 U. S. 473, 480, and citations there given).

formed under it, and that the State might modify it *prospectively or retrospectively* without infringing the article of the Federal Constitution * * *."

3. **If the extent of the reserved power is in doubt, every intendment is in favor of the decision of the Supreme Court of California, because the reserved power must be construed in favor of the state, and because all presumptions favor the constitutionality of laws.**

Pearsall v. Great Northern R. Co., 161 U. S. 646, 664;

Hoge v. Railroad Co., 99 U. S. 348, 354-355;

Fletcher v. Peck, 6 Cranch, 87, 128;

Charles River Bridge v. Warren Bridge, 11 Pet. 420;

Whitney v. California, 274 U. S. 357, 371.

FIFTH: NONE OF THE AUTHORITIES CITED BY PETITIONER MAKES AGAINST THE FOREGOING CONCLUSIONS.

In all the cases cited by petitioner involving the alteration or repeal of statutes imposing stockholders' liability, the state had either not reserved any power of amendment or repeal, or, if it had, the reserved power was not noticed or mentioned by court or counsel.

In *Hawthorne v. Calef*, 2 Wall. 10, which is petitioner's principal authority, and the authority for practically all of the cases cited by him, *the particular corporation, Kennebec and Portland Rail Road Company, was expressly exempted from the operation of the reserved power contained in the general laws.* The reserved power was contained in a general "Act concerning Corporations," ap-

proved March 17, 1831 (Laws of Maine, 1831, Ch. 503, p. 1289). The charter of the Kennebec and Portland Rail Road Company in so many words made that law inapplicable to it. In the railroad's charter it was provided:

> "That the provisions of an 'Act concerning Corporations' passed March seventeenth one thousand eight hundred and thirty one, shall not extend to or apply to the Company hereby incorporated" (Laws of Maine, 1836,* Ch. 227, Sec. 9, p. 313).

In *Ochiltree v. Railroad Co.*, 21 Wall. 249, the reserved power was not mentioned or considered. In that case a railroad company became indebted to Ochiltree at a time when stockholders under the Missouri law were liable for their stock subscriptions and a like amount in addition. When Ochiltree extended his credit, only a part of the stock of the railroad company had been subscribed for. Before the defendant subscribed for stock, the double liability was abolished. The question in the case was whether stock subscribed for after abolition of the liability, and after Ochiltree extended credit, could be held liable to him. The court held that it could not be. The statements in the opinion regarding the possible liability of stock issued before the repealing act, are, therefore, *obiter dictum*. Without taking from the high respect which we accord to any statement of this court, whether *obiter* or not, we submit that the statements in the *Ochiltree* case are not persuasive upon the subject of reserved power, which was neither mentioned by the court nor involved in the case.

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*The corporation involved was organized, not in 1846, as petitioner states (Supplement to Petitioner's Brief, p. 9), but in 1836, by special act of incorporation (Laws of Maine, 1836, Ch. 227, p. 306, et seq.). The charter was amended in 1846 so as to add provisions not material here.

Bernheimer v. Converse, 206 U. S. 516, we submit, is but an application of the familiar principle that a change in remedy does not of itself infringe constitutional rights (206 U. S. 530-531). The point decided was that a Minnesota statute changing the procedure for enforcing existing stockholders' liability did not unconstitutionally affect the stockholders' rights. The reserved power was not discussed or mentioned, nor, we submit, was it material, because a change in remedy can be made without any reserved power.

Blackburn v. Irvine (3rd C. C. A.), 205 Fed. 217, and *Irvine v. Elliott* (D. C. Del.), 203 Fed. 82, cases under an Ohio statute, involved much the same situation as *Bernheimer v. Converse,* and neither of these cases stands for any broader rule. In neither of them was the reserved power mentioned or considered.

Harrison v. Remington Paper Co. (8th C. C. A.), 140 Fed. 385, was also a case in which the reserved power was not mentioned or considered.

The opinion in *Woodbine Savings Bank v. Shriver* (Iowa), 226 N. W. 374, cited by petitioner, was reconsidered and superseded by a later opinion in the same case (236 N. W. 10). The second opinion sustained the statute in question, as against the stockholder, on the ground that it only brought about a change in the remedy for enforcing an existing right. In so far as the case has anything to do with the question before this court, the second opinion is an authority against the petitioner.

In *Pate v. Bank of Newton,* 116 Miss. 666, 77 So. 601, a suit on behalf of the depositors of a bank against the stockholders, it was expressly alleged (77 So. 602) "that

all the deposits were contracted subsequent to the passage of the Banking Act" which imposed the liability.

The case of *Bank of the Old Dominion v. McVeigh*, 20 Grat. (Va.) 457, involved a statute relative to payment of debts in Confederate money. Petitioner's citation of it as a case dealing with the repeal of a stockholder's liability law is obviously an inadvertence.

Petitioner cites the rule that the legislature cannot so reduce the taxing power of a municipality as to destroy the power of the municipality to pay its debts (Supplement to Petitioner's Brief, p. 17). No inference in support of petitioner's contention can be drawn from this rule. As to private corporations, as shown by many cases already cited (supra pages 35-36), the state may exercise the reserved power notwithstanding that the exercise thereof may incidentally impair the corporation's power to pay its debts.

The case at bar differs from each and all of the petitioners' authorities in another particular which, in itself, we submit, is of controlling importance. The "contract" in the case at bar, included as one of its terms the rule of law which prior to the making thereof had been settled by *Moss v. Smith*, 171 Cal. 777, 155 Pac. 90, and other California cases already cited. No authority cited by petitioner involved or considered such a situation.

SIXTH: THE DECISION OF THE SUPREME COURT OF CALIFORNIA UPON THE MATTERS OF STATE LAW ARGUED BY PETITIONER WILL NOT BE REVIEWED BY THIS COURT.

Petitioner argues (citing the opinion of Justice Langdon, dissenting from the denial of the petition for rehearing) that the reserved power of repeal in California applies only to legislative acts, and not to constitutional provisions (Supplement to Petitioner's Brief, p. 5). The decision of the Supreme Court of California, however, was to the contrary, and this court has decided that such a question is settled by the decisions of the Supreme Court of the state. In *Fair Haven R. Co. v. New Haven,* 203 U. S. 379, this court said (p. 388):

> "We accept the decision of the Supreme Court of Errors, that the statutes were intended as an exercise of the power of amendment reserved by the State, although plaintiff in error contends that such was not their intention."

To the same effect are:

Stone v. Wisconsin, 94 U. S. 181;

Barnitz v. Beverly, 163 U. S. 118, 122.

Again, petitioner argues that the reserved power in section 1 of article XII is limited by the impairment of contract clause in section 16 of article I of the constitution of California, and that the decision of the State Supreme Court gave an improper construction to these provisions of the state constitution (Supplement to Petitioner's Brief, p. 20). We submit that all questions as to the intent and meaning of the state constitution are settled by the decision of the state court. Just as this court

must determine the federal constitutional question for itself (*Minneapolis etc. R. Co. v. Gardner*, 177 U. S. 332, 340), so the state court is entitled to decide the meaning and purpose of the state constitution and laws. In other words, the state court had the right to decide what the people of the state intended by the repealing provision and this court will decide whether the carrying out of such intent in this case will infringe the impairment of contract clause in the Federal Constitution. In *Thornton v. Duffy*, 254 U. S. 361, this court said (p. 368):

> "We repeat, we must accept the decision of the court as the declaration of the legislation and the requirement of the constitution of the State, as much a part of both as if expressed in them (*Douglass v. County of Pike*, 101 U. S. 677)."

To the same effect are:

Douglas v. Noble, 261 U. S. 165, 168;

Detroit & Mackinac R. Co. v. Fletcher Paper Co., 248 U. S. 30, 31;

Converse v. Hamilton, 224 U. S. 243, 253.

CONCLUSION.

We have made our arguments without extended reference to the two opinions of the Supreme Court of the State of California, because the question for consideration on this writ of review is the correctness of the decision of that court. We ask, however, for those two opinions the weight to which they are entitled, in the first place by reason of a principle long established by this court, and,

in the second place, by reason of their own intrinsic soundness.

The rule of this court is not lightly to disregard any decision of a State Supreme Court, but, on the contrary, to give it the benefit of every intendment consistent with the obligation of this court to determine any federal question properly before it (*Wyandotte Gas Co, v. Kansas,* 231 U. S. 622, 626).

The two opinions of the Supreme Court of California here under review were rendered after a full presentation of substantially all of the arguments and authorities which have been presented to this court by petitioner. The opinions are not long; but, we respectfully submit, they state in a clear and concise manner a conclusion upon the federal question here under review, which is in strict accord with the pertinent decisions of this court.

We respectfully submit that the order of the California Supreme Court, dismissing the appeal in the case at bar, after the constitutional provision on which it was based had been repealed, did no more than give effect to one of the basic terms of the "contract" on which the suit was based.

Dated, San Francisco,
February 13, 1932.

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